 

The state and evolution of the Asian cross-border corporate bond markets

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In August 2017, ICMA, under the initiative of its Secondary Market Practices Committee (SMPC), began its study into the state and evolution of the Asian cross-border corporate bond markets. Similar to previous work conducted by the SMPC related to the European corporate bond market, the focus is very much on the developments and forces impacting the secondary market. In particular the study seeks to identify key trends and changes in market structure and participation, as well as exploring the effects of regulation and monetary policy in light of these trends and developments, and how, in combination, this is impacting market evolution, efficiency, and liquidity.

The study is largely qualitative in approach, and based on extensive interviews with market participants and stakeholders, including sell-side and buy-side firms, intermediaries and infrastructure providers, issuers, as well as regulators and policy makers. ICMA has already conducted a number of interviews in the region, and encourages its APAC members who have not yet participated to contribute to the study. ICMA will look to finalise its report in the first half of 2018.

The Asian cross-border corporate bond markets

What becomes clear from preliminary interviews is that there is no "Asian" corporate bond market as such; rather, there are multiple local markets, which are largely heterogeneous and idiosyncratic in nature, structure, and participation. To this extent, the focus of the study is very much on the international, cross-border segments of the regional credit markets. In practice, this is primarily the regional USD corporate bond market, although, increasingly, the onshore renminbi (CNY) market is establishing itself internationally.

The regional USD corporate bond market currently stands at around $850 billion, of which a little more than $500 billion[44] is made up of financial issuance (largely banks). In terms of non-financial corporate (NFCs) issuance, Australian issuers dominate for now, followed by Indonesian, Japanese, Korean, Singaporean, Hong Kong, Indian, and Malaysian issuers, while Chinese banks constitute the largest source of financials issuance, comfortably eclipsing Australian and Japanese financials.

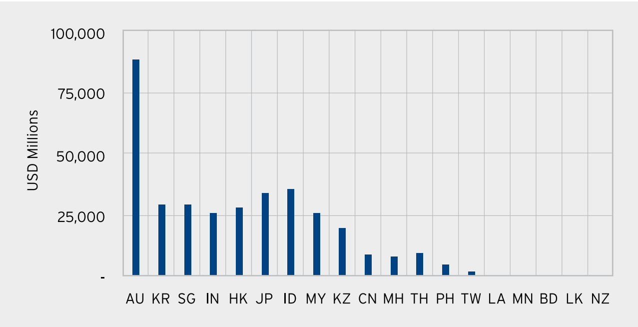
Primary market liquidity

From the preliminary interviews, it would seem that the Asian USD market is in good health, with growing net issuance, new regional issuers coming to the market, and larger issues. As one respondent pointed out, five years ago the common issue size for an investment grade (IG) entity was around $500 to $750 million. Today, it is not unusual to see issues in the $2 to $4 billion range.

44. Based on RegS issuance by APAC incorporated financial entities.

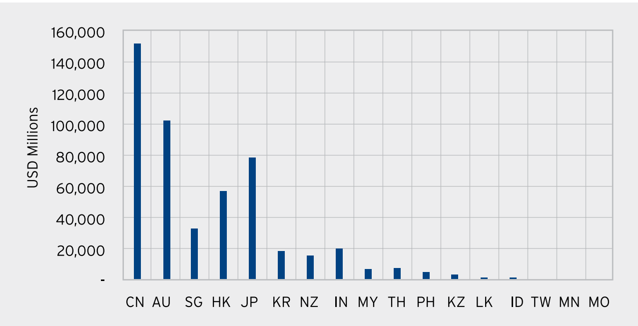
Regional demand is also buoyant. Whereas historically large marque issues would require a 144A tranche to ensure full participation, these days large issues are almost exclusively issued under RegS. In fact, the story seems to be that supply is not keeping up with demand for regional USD corporates, particularly as dollar-rich Chinese onshore funds become a larger part of the regional investor base. A common concern is that this demand-supply imbalance is affecting valuations, with spreads at levels that are difficult to rationalise.

Outstanding APAC USD denominated NFCs (Total $354.2bn)



Source: Bloomberg

Outstanding APAC USD denominated Financials (RegS) (Total $502.8bn)



Source: Bloomberg

Secondary market liquidity

So far, the interviews paint a mixed picture with respect to secondary market liquidity. Some respondents (both sell-side and buy-side) suggest that secondary market liquidity is poor, mainly as a result of small overall market size, a tendency for regional investors to "buy and hold", and the reduced capacity for the traditional global banks to provide meaningful market-making services. However, other respondents maintain that, at least in relative terms, liquidity is comparable with the US and European markets, with ticket sizes of $10 to $20 million easily executable, tight bid-ask spreads, and an increased pool of regional market makers without the capital constraints of their international competitors.

Financing and hedging markets

The discussions so far point to concerns about the absence of deep and liquid repo and credit default swap (CDS) markets, which, to an extent, also affects market efficiency and liquidity. It has been highlighted that many regional investors are not actively involved in the securities lending or repo market, mainly due to legal and contractual barriers, which limits supply to support secondary market making. As one buy-side respondent explained, either investors accept settlement fails as normal, or market makers cannot provide offer-side liquidity in bonds they do not already hold.

The lack of a meaningful single name-CDS market is attributed to a number of factors, not least the fact that credit spreads are tight, and volatility low, which makes hedging less cost effective. The increased capital constraints of traditional market makers further supress activity.

E-trading

The ongoing electronification of the European credit markets is a key theme of ICMA's work, and a major focus of the study is on the uptake of new platforms and e-protocols in the Asian markets. The initial feedback seems to be that the region is moving relatively slowly in this respect. One electronic trading venue dominates, although there is some growing traction with other established US and European platforms. But ultimately, the Asian credit markets are very much over-the-counter. Relationships and personal networks are fundamental to market functioning, and, as one respondent suggested, the trust and integrity of counterparties is a critical dynamic. One interviewee used the expression "a human dark pool" to describe the structure of the Asian markets. Accordingly, trading platforms are used mainly for smaller transactions, or for supporting post-trade processes following OTC execution; thus, usage is driven more by efficiency and compliance requirements, rather than for sourcing liquidity.

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